that test was .778.

Finally, in Attachment R3, I test the hypothesis that the 1990 through 1992 period is the same as the 1960 through 1980 period. Again, a t-test on the 1990 through 1992 dummy cannot deny that the 1990 through 1992 period is the same as the 1960 through 1980 period. The t-statistic for this test is -1.051. In all of these tests I used the Bush-Uretsky data, even though I am skeptical of their methodology for obtaining the U.S. price series.

Q. Don't your results show a positive differential through the 1984 through 1989 period and doesn't this support the hypothesis relied upon by Bush-Uretsky?

A. No. At best it indicates there was a statistically insignificant short run aberration in the difference, probably due to markets adjusting to eliminate the difference.

Q. Well, shouldn't that be adjusted for in the "x" factor?

A. Absolutely not. To do so means that the California Public Utilities Commission is reacting to the noise in the system. Any quality control engineer will tell you that you do not respond to noise, only real and permanent changes in structure. The same is true for economic systems. Responding to noise gains nothing, is expensive, and may destroy the system.

In fact, looking at Attachment R3, it shows the LEC input price growing faster than the U.S. input price index. However, this result is not significantly different from zero, so adjusting the "x" factor downward, as would be consistent with Dr. Selwyn's flawed approach, though it would benefit us, is uncalled for. To do so would simply be responding to noise as Dr. Selwyn has.

Q. What then can we conclude about the use of the Bush-Uretsky results in determining whether the LEC input price index differs from the U.S. input price index by more than random fluctuations?

A. We can conclude nothing from their analysis because of the errors discussed above. The properly done analysis is the analysis presented in my direct testimony. From that analysis, we can conclude that there is no long run differential between the series and as a consequence there should be no input price adjustment to the "x" factor. Further, the Christensen study can be accepted in totality as a basis for calculating an "x" factor (if the Commission persists in its reliance on an "x" factor).

Q. Does this complete your testimony.

A. Yes it does.

NRF REVIEW: ATTACHMENT R1

Autoreg Procedure

Dependent Variable = DIFF

Ordinary Least Squares Estimates

SSE	379.308	DFE	31
MSE	12.23574	Root MSE	3.497963
SBC	181.2237	AIC	178.2307
Reg Rsq	0.0315	Total Rsq	0.0315
Durbin-Watson	1.8908		

Variable	DF	B Value	Std Error	t Ratio	Approx Prob
Intercept	1	0.20434783	0.7294	0.280	0.7812
D83	1	1.33065217	1.3250	1.004	0.3230

Estimates of Autocorrelations

Preliminary MSE = 9.850376

Estimates of the Autoregressive Parameters

Lag	Coefficient	Std Error	t Ratio
6	0.37816933	0.16901558	2.237482

NRF REVIEW: ATTACHMENT R1

Yule-Walker Estimates

SSE	298.3924	DFE	30
MSE	9.946415	Root MSE	3.153794
SBC	177.7282	AIC	173.2387
Reg Rsq	0.0318	Total Rsq	0.2381
Durbin-Watson	1.8787		

Variable	DF	B Value	Std Error	t Ratio	Approx Prob
Intercept	1	0.24137214	0.5122	0.471	0.6409
D83	1	1.03625924	1.0434	0.993	0.3286

NRF REVIEW: ATTACHMENT R2

Autoreg Procedure

Dependent Variable = DIFF

Ordinary Least Squares Estimates

SSE	361.901	DFE	30
MSE	12.06337	Root MSE	3.473236
SBC	183.17	AIC	178.6804
Reg Rsq	0.0760	Total Rsq	0.0760
Durbin-Watson	1.9198		

Variable	DF	B Value	Std Error	t Ratio	Approx Prob
Intercept	1	0.20040000	0.6946	0.288	0.7750
D84	1	2.93710000	1.8704	1.570	0.1268
D89	1	0.42210000	1.8704	0.226	0.8230

Preliminary MSE = 8.600547

Estimates of the Autoregressive Parameters

Lag	Coefficient	Std Error	t Ratio
1	0.03973506	0.18794853	0.211415
2	0.20875056	0.18471055	1.130150
3	0.10919051	0.18861171	0.578917
4	0.09286239	0.18861171	0.492347
5	0.17475332	0.18471055	0.946093
6	0.39013900	0.18794853	2.075776

NRF REVIEW: ATTACHMENT R2

Yule-Walker Estimates

SSE	249.0162	DFE	24
MSE	10.37568	Root MSE	3.22113
SBC	193.0673	AIC	179.5987
Reg Rsq	0.1083	Total Rsq	0.3642
Durbin-Watson	2.084		

Variable	DF	B Value	Std Error	t Ratio	Approx Prob
Intercept	1	0.23968673	0.3564	0.673	0.5076
D84	1	1.72445628	1.4882	1.159	0.2580
D89	1	1.22681341	1.5777	0.778	0.4444

NRF REVIEW: ATTACHMENT R3

Autoreg Procedure

Dependent Variable = DIFF

Ordinary Least Squares Estimates

SSE	251.5197	DFE	28
MSE	8.982846	Root MSE	2.99714
SBC	178.1559	AIC	170.6734
Reg Rsq	0.3578	Total Rsq	0.3578
Durbin-Watson	2.3505		

Variable	DF	B Value	Std Error	t Ratio	Approx Prob
Intercept	1	0.40666667	0.7739	0.526	0.6034
D75	1	0.83333333	1.5477	0.538	0.5945
D80	1	-2.48666667	1.5477	-1.607	0.1193
D85	1	4.30133333	1.5477	2.779	0.0096
D90	1	-2.20333333	1.8956	-1.162	0.2549

Preliminary MSE = 5.108729

Estimates of the Autoregressive Parameters

Lag	Coefficient	Std Error	t Ratio
1	0.30359715	0.19630831	1.546532
2	0.35754549	0.20635529	1.732669
3	0.25101082	0.21930108	1.144595
4	0.08129391	0.21930108	0.370695
5	0.05629462	0.20635529	0.272804
6	0.39011156	0.19630831	1.987239

NRF REVIEW: ATTACHMENT R3

Yule-Walker Estimates

SSE	142.82	DFE	22
MSE	6.491818	Root MSE	2.547905
SBC	181.955	AIC	165.4935
Reg Rsq	0.5868	Total Rsq	0.6353
Durbin-Watson	2.0055		

Autoreg Procedure

Variable	DF	B Value	Std Error	t Ratio	Approx Prob
Intercept	1	0.45273438	0.3090	1.465	0.1570
D75	1	0.70479795	0.8109	0.869	0.3942
D80	1	-2.85777964	0.7798	-3.665	0.0014
D85	1	3.94521142	0.8305	4.751	0.0001
D90	1	-1.30615378	1.2430	-1.051	0.3048

Certificate of Service

I, Ann D. Berkowitz, hereby certify that copies of the foregoing "GTE's Comments" have been mailed by first class United States mail, postage prepaid, on the date the Commission reopened to all parties of record.

Ann D. Berkowitz

APPENDIX G

1/17/96

RECEIVED

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Treatment of Operator Services Under Price Cap Regulation	)	CC Docket No. 93-124

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OFFICE OF SECRETARY

REPLY COMMENTS OF GTE

GTE Service Corporation and its affiliated domestic telephone operating companies

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Their Attorney

January 16, 1996

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SUMMARY

GTE urges the Commission to move forward with its "procompetitive agenda" and adopt changes in baseline price cap regulation without regard to the actual level of competition present. The proposals set forth in the *Second Further Notice of Proposed Rulemaking* (*"Second Notice"* or *"SFNPRM"*) for baseline changes in the price cap plan provide a reasonable framework for adapting price cap regulation to the *emergence* of competition.

Because there is a critical need for immediate new services flexibility, GTE strongly supports the Commission's efforts to adopt changes to the new services rules, to eliminate the need for LECs to seek a waiver of Part 69, to adopt separate tariff standards for Alternative Pricing Plans, to extend zone pricing to most access rate elements, to allow LECs to employ contract-based tariffs subject to appropriate safeguards, to remove limitations on downward pricing flexibility, to simplify the price cap basket structure and to establish the criteria to define relevant markets and the terms by which these markets can receive streamlined or nondominant treatment.

As the Commission has recognized in the *SFNPRM*, access competition has developed steadily in many markets since the Commission first adopted its LEC price cap plan. It is well documented, in this proceeding and in others, that there is facilities-based competition for LEC access services in a significant number of markets today. LECs have shown that a significant percentage of their access revenues is subject to erosion. At least 27 CAPs have established a presence in 106 GTE central office serving areas in 16 states. GTE is also facing

formidable competition from other providers as well. Cable companies already have facilities in place which reach most customers in many markets; major IXCs have announced their decision to directly compete in local and access markets; and existing wireless providers already reach a significant, and rapidly growing, proportion of the telecommunications users in the United States.

The *SFNPRM* draws a fundamental distinction between changes to "baseline" price cap regulation, which should not be conditioned on a demonstration of competition, and "streamlined" regulation, which should be based on a finding that competition in a relevant access market is sufficient. This distinction, which many commenters choose to ignore, is a reasonable basis for Commission action in this proceeding and should be maintained.

Baseline changes will provide economic and public benefits regardless of the level of competition present. Granting LECs greater pricing flexibility will encourage the development and introduction of new and better services; will result in the development of more efficient access pricing by allowing LECs to establish access prices which more closely reflect underlying costs; and will work to send more accurate price signals to guide efficient investment in the infrastructure by incumbents and entrants alike. Because of these benefits, policies to encourage efficient pricing should be initiated *before* there is any evidence that competition is affecting pricing decisions. As a result, customers will be the ultimate beneficiaries of vigorous price and service quality competition.

Baseline price cap changes proposed by the Commission, and the modifications as suggested by GTE, would continue to provide adequate safeguards. LECs would still be prevented from offsetting losses for competitive services with higher prices for less-competitive services. LECs would have little incentive or opportunity to engage in anti-competitive pricing and the anti-discrimination provisions of Section 202 of the Act and the Commission's statutory responsibility to ensure just and reasonable rates would continue to apply.

The Commission should also take action now to establish a framework for streamlining LEC access markets based on clearly established criteria. LEC competitors again assert that the current level of competition does not warrant the adoption of standards to treat LEC service under streamlined or nondominant carrier regulation. However, the matter under consideration in this proceeding is not whether any particular access market is competitive, but whether a framework should be established which will adapt to competition as it develops. Then, if a market does not meet the criteria established, it would not be streamlined. It is not at all "premature" to establish a framework for the criteria and procedures for streamlining.

The Commission should define the geographic dimension of relevant markets by establishing reasonable guidelines for grouping wire center serving areas. The wire centers in each group should be required to be contiguous, and some part of each wire center would have to be included in an addressable "footprint." Relevant markets should be based on a combination of the geographic, service and customer dimensions. Further, measures of supply and demand elasticity should be established as criteria for streamlining.

Finally, GTE urges the Commission to adopt standards for applying nondominant regulation to LEC services. The Commission should conclude that a LEC is nondominant in any new market it enters outside its traditional serving area, that a nondominant framework would be based on the framework adopted for streamlining, and that any LEC found to be nondominant in a given market should be regulated in the same manner as any other nondominant carrier with which it must compete.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
	)	
Treatment of Operator Services Under Price Cap Regulation	)	CC Docket No. 93-124
	)	

REPLY COMMENTS OF GTE

GTE Service Corporation ("GTE"), on behalf of its affiliated domestic telephone operating companies, submits the following Reply in response to comments submitted regarding the *Second Further Notice of Proposed Rulemaking* (*"Second Notice"* or *"SFNPRM"*) in the Price Cap Performance Review for Local Exchange Carriers, FCC 95-393, released September 20, 1995.

I. INTRODUCTION

Building on its earlier finding articulated in the *First Report and Order* that competition is indeed emerging in access markets, the *Second Notice* (at ¶11) sets out to achieve the Commission's clearly articulated goals: encourage market based prices that reflect the cost of access services; encourage efficient investment and innovation; promote competitive entry; and permit regulation of noncompetitive markets in an efficient and least intrusive way. Accordingly, GTE endorsed the proposals in the *Second Notice* to improve the efficiency of the Local Exchange Carrier ("LEC") price cap plan.

In its Comments, GTE urged the Commission to adopt improvements in baseline price cap regulation, without regard to the extent of competition in those markets. Because there is a critical need for immediate new services flexibility, GTE strongly supported the Commission's efforts to adopt changes to the new services rules, to eliminate the need for LECs to seek a waiver of Part 69 in order to offer a new switched access service, and to adopt changes which would accommodate optional discounted services by establishing separate tariff standards for Alternative Pricing Plans ("APPs"). To align access rates more closely with differences in cost, GTE recommended that zone pricing should be extended to most access rate elements. GTE also urged the Commission to permit LECs to employ contract-based tariffs, subject to appropriate safeguards, under baseline regulation and to revise its current policy regarding Individual Case Basis ("ICB") rates to encourage development of new service offerings. Limitations on downward pricing flexibility should be removed, and GTE also encouraged the Commission to simplify the price cap basket structure in this proceeding.

GTE commends the Commission for tentatively proposing a system of adaptive regulation for LEC interstate access services and encourages the Commission to establish the criteria to define relevant markets and the terms by which these markets can receive streamlined treatment. The mechanism for adaptive regulation should be simple and predictable; it should allow LECs to respond to competition and it should ensure that customers in less competitive markets continue to be protected by price caps.

Finally, GTE strongly endorses proposals which would establish procedures for reclassifying those LEC services not already found to be nondominant. The criteria for the determination of nondominance should be similar to those used for streamlining, relying on indicators which are simple to measure and for which clear thresholds can be defined. A LEC found to be nondominant in a given market should be regulated in the same manner as any other nondominant carrier with which it must compete in that market.

II. BASELINE PRICE CAP RULES MUST REFLECT THE COMPETITIVE LANDSCAPE IN WHICH LECS OPERATE TODAY.

A. Baseline price cap changes should not be conditioned on a demonstration of competition.

With respect to changes proposed for baseline regulation, the Commission stated in the *Second Notice*: "we propose generally that these rule revisions be effective for all price cap LECs *without regard to the level of competition* because they will serve our goal of moving prices towards cost, encouraging efficient investment in infrastructure, and ultimately producing robust competition."[1] (emphasis added) In essence, the proposals set forth by the Commission for baseline changes in the price cap plan provide a reasonable framework for adapting price cap regulation to the *emergence* of competition.[2]

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1 *Second Notice* at ¶2.

2 In recent months, several Commissioners have recognized the need to revise regulation of LEC services to accommodate emerging competition: "If we do not proactively reform current rules, we may severely limit the breadth and depth of real competition." Speech by Chairman Reed Hundt, Telecompetition '95, Washington D.C,, December 5, 1995, at 2,3. "The FCC is moving forward with a procompetitive agenda...As competition begins to take hold in local exchange and access markets, I believe our access charge rules may become counterproductive...We must develop more durable price cap rules...strive to tailor our price caps rules so that they acknowledge and accommodate competition." "Our rules should be flexible and adaptive." Remarks of

In stark contrast to this "pro-competitive policy" direction and the clear emergence of competition for LEC access services, the Comments of exchange carriers' competitors in response to the *Second Notice* diametrically oppose making any changes in baseline price cap rules for LECs to make them more adaptive to current market conditions. In most cases, these commenters, many of whom provide services in direct competition with LEC local and access services, deny that there is any real growth in competition in access markets and cite concerns over possible exploitation of market power if LECs are granted *any* additional flexibilities. Generally, these competitors insist that any additional pricing flexibilities be tied to an overly broad showing of effective competition. Others insist that no pricing flexibility be granted until markets for local telephone services become much more competitive or until the Commission conducts a comprehensive proceeding to reform its access charge rules.

The Commission should not be guided by these self-serving comments. The *Second Notice* draws a fundamental distinction between changes to "baseline" price cap regulation, which should not be conditioned on a demonstration of competition, and "streamlined" regulation, which should be based on a finding that competition in a relevant access market is sufficient to discipline the LEC's actions. This distinction, which many commenters choose to ignore, is a reasonable basis for Commission action in this proceeding and should be maintained.

The Commission must adopt changes to baseline regulation which will further the Commission's goals even if competition is not sufficient to replace price caps as a constraint on LEC pricing in a given market. GTE will show *infra* why the *SFNPRM*

Commissioner Rachelle Chong Before the Practicing Law Institute and Federal Communications Bar Association, December 14, 1995.

proposals, with the modifications recommended by GTE, would: allow access prices to better reflect costs; encourage efficient investment; promote efficient competitive entry; and reduce unnecessary interference in access markets. These changes would allow the price cap mechanism to more closely replicate a competitive outcome, without causing "competitive harm." Because these changes would be beneficial even in the absence of effective competition, they should not be conditioned on any competitive criteria.[3] As discussed *infra*, the Commission should also establish an adaptive framework which will remove price cap regulation when the growth of competition in an access market makes price caps unnecessary. This streamlining would be conditioned on criteria which would measure a LEC's market power in specific markets.

B. Competition exists for LEC access services.

Several commenters argue that the Commission is premature in advancing the *SFNPRM* proposals, claiming that access competition has not yet developed.[4] In fact, none of the changes proposed in the *SFNPRM* would require the Commission to find that any particular access market is competitive today. The proposed baseline changes do not and should not presume that any competitive criteria have been met.

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3 As discussed *infra*, no competitive "checklist" should be adopted as a precondition for changes in baseline regulation. Even if all of the "checklist" conditions proposed by commenters were relevant to the measurement of market power -- which is not the case -- they would not be useful in determining whether the proposed baseline changes should be adopted, since these proposals are not based on any assumption regarding LEC market power. Further, the proposed "checklist" items should only be incorporated into the competitive criteria for streamlined regulation if they are found to be necessary for a determination of market power in a particular access market.

4 *See, e.g.,* Telecommunications Resellers Association ("TRA") at 4-5, Sprint Telecommunications Venture ("SVT") at 3, MFS at 1.

Furthermore, while the proposals for streamlining and nondominant treatment would apply to competitive markets, this *Second Notice* is considering adopting only a framework. No access market would actually be afforded streamlined treatment until the LEC had demonstrated that the criteria established in the framework had been satisfied. The proposals therefore are not premature, regardless of the actual state of competition.

Of course, as the *SFNPRM* recognizes (at ¶5), access competition has developed steadily in many markets since the Commission first adopted its LEC price cap plan. In 1990, there were only a handful of competitive access providers. Today, there are carriers competing for LEC services in hundreds of access markets, both large and small. It is well documented, in this proceeding and in others, that there is facilities-based competition for LEC access services in a significant number of markets today. USTA identifies a substantial number of CAPs actively operating in over 550 separate markets.[5]

For example, within GTE's service areas, a significant percentage of its access revenues is subject to erosion. At least 27 CAPs have established a presence in 106 GTE central office serving areas in 16 states. These serving areas, while representing only three percent of GTE's total central offices, generate nearly 25 percent of GTE's

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5 *See* USTA Attachment 2. While the *SFNPRM* observes (at n.2) that the growth of competition is most pronounced in major urban markets, the USTA list makes it clear that competitive entry has moved well beyond a few major cities, to include virtually any area which has a customer base that generates high levels of demand. Thus, GTE faces competition not only in large metro areas around Los Angeles and Dallas, but in medium-sized cities like Tampa, Florida and Beaverton, Oregon, as well as in less obvious places such as Harrisonburg, Virginia, Broken Arrow, Oklahoma, and Andalusia, Alabama.

total equivalent minutes of use.[6] Claims that access service competition does not exist or is not likely to develop soon is a gross misstatement and completely ignores the facts.

CAPs, of course, are not the only sources of access competition. Cable companies already have facilities in place which reach most of the customers in many markets.

> For example, a high proportion of households has both standard telephone service and cable telecommunications services. In August 1993, it was estimated that over ninety-one million homes have cable service available. The coaxial cable that delivers cable television is already capable of delivering telephone and other telecommunications services as well. Cable companies, now allied with out-of region telephone companies, are reportedly planning to spend fourteen billion dollars deploying fiber over the next decade.[7] (footnotes omitted)

Since cable firms control most of the larger CAPs, the power of the cable-CAP combination cannot be ignored. AT&T is currently reorganizing itself to prepare for its re-entry into local and access markets, and MCI has already formed a subsidiary for that purpose. Existing wireless providers already reach a significant, and rapidly growing, proportion of the telecommunications users in the United States. PCS providers have already invested six billion dollars to obtain licenses in the auction held

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6 For a more thorough discussion of the extent of competition in GTE serving areas, *see* Exhibit 2, GTE Telephone Operating Companies Petition for Waiver of Part 69 Rules to Geographically Deaverage Switched Access Services, filed November 27, 1995 (GTE "ZonePlus" Plan).

7 Spulber, Daniel F., "Deregulating Telecommunications," Yale Journal on Regulation, Volume 12 Number 1, Winter 1995, at 39.

by the Commission last year, and in doing so have committed themselves to still further investments to meet their build-out requirements.[8]

Interestingly, many commenters opposed to additional baseline pricing flexibility cannot even agree among themselves whether competition truly exists in the market today. For example, AT&T (at 2), MCI (at 33) and TRA (at 4) suggest that no real competition exists, but the California Cable Television Association ("CCTA") refers (at 14) to "several hundred networks operational or under construction" and that in the long run "there will be sufficient competition" to discipline LEC behavior.[9]

In an attempt to downplay the true extent of competition, several commenters attempt to distort the true picture of the competitive landscape. These parties generally misspecify the relevant market. Any analysis of competition for LEC access services should properly focus on that set of substitutable services provided in a given customer segment within a specific geographic market. The fact is, end users are exercising their options today. LEC switched and special access services are highly elastic, particularly for large end user customers in certain markets. It is in these markets that competition is emerging and for which pricing flexibility is warranted.

Some commenters attempt to paint CAP operations as severely limited and inflexible with respect to their ability to serve customers. For example, AT&T (at 14)

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8 To meet these build-out requirements, it is estimated that PCS firms will invest another $30 to 50 billion. This will make PCS service available to most customers in 51 major market areas across the country, with a combined population of approximately 200 million people. This is not, as some commenters would suggest, merely a possibility, it is a commitment to which the major firms in the industry have already staked $7 billion in earnest money. *See* Nicholas W. Allard, "The Brave New World of PCS," PCS Focus, August, 1995

9 Similarly, Cox (at 6, n.15) states that "alternative facilities-based networks are already here and the Commission should support their use to full capacity."